

# Cyprus Tax Alert

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## **DOUBLE TAX TREATY BETWEEN CYPRUS AND RUSSIA**

On April 21, 2009, the Russian Federation and the Republic of Cyprus signed a Protocol amending the Double Tax Treaty between the two countries, which has been in place since 1998.

The removal of Cyprus from the black list, placed there in 2008, means that Russian companies with Cypriot subsidiaries can qualify for the Russian dividend participation exemption.

Furthermore, one of the most beneficial aspects of the Treaty, the withholding tax rates applying to cross border payments remained unchanged.

Please see below most important amendments of the protocol

### **1. Changes relating to Capital Gains on Indirect Sale of immovable property**

Capital gains on the disposal of shares remains subject to taxation on the country of tax residence of the seller.

Currently, capital gains from the sale of shares in a Russian subsidiary by its Cypriot parent company are tax exempt in both jurisdictions, even if the subsidiary owns real property in Russia. (In Cyprus such capital gains are not subject to taxation).

The amended treaty now provides that gains derived by a resident of the contracting state from the sale of shares of a company which has more than 50% of their value from immovable property situated in another contracting state may be taxed in that country. This provision is in line with the OECD Model Tax Convention on Income and Capital.

In the following cases, the exclusive taxing right will remain with the country of residence of the seller:

- the disposal qualifies as a corporate reorganization or
- the disposed shares are listed on a recognized stock exchange or
- the seller is a pension fund, provident fund or the government of the two countries

On 29 December 2016 the Cyprus Ministry of Finance announced that an agreement has been reached between Cyprus and Russia for postponing the application of the Protocol amending Article 13 “Gains from Alienation of Property” of the Double Tax Treaty (DTT) agreement between Cyprus and the Russian Federation.

The provisions of the article were deferred in order to allow for Russia to renegotiate similar provisions in its DTTs with other countries. Such negotiations however never took place as countries refused to negotiate as a result of the sanctions imposed on Russia. This left Cyprus in a position of disadvantage, which is now being regularised through amending the original protocol, removing the provision altogether.

According to a press release issued by the Ministry of Finance on the issue, a supplementary protocol is currently being prepared in which the revised provisions of Article 13 of the DTT will be suspended until the introduction of agreed provisions in other bilateral agreements with other European countries

## **2. Exchange of Information Article**

The Protocol introduces an article on the Exchange of Information between the competent authorities of the Contracting States. It is identical to the Article 26 of the OECD model.

It clarifies powers and obligations of the tax authorities of both countries, aligns itself towards OECD standards on fiscal transparency and exchange of information on tax matters.

The information exchange is restricted in various ways by the the domestic laws of the Contracting States. Cyprus is not required to supply information which is not obtainable under its own laws or in the normal course of administration. Moreover, the new transparency requirements should not adversely affect legitimate tax-efficient structures.

## **3. Limitation of Benefits**

The Treaty has also been amended by the insertion of a new Article on "Limitation of Benefits."

The operating principle of this new Article is that the benefits provided by the Treaty to Russian and Cypriot residents will not be available if the main purpose (or one of the main purposes) for establishing residence in one of the Contracting States is to obtain such tax benefits, which would not otherwise be available.

The rule seems to have a relatively narrow application, as its scope is limited to companies that are not registered in either Contracting State but are nevertheless claiming Treaty benefits. So, it appears that this anti-avoidance rule would not apply to a Cypriot incorporated company or a Russian incorporated company but only to foreign companies claiming tax residency through the management and control test.

## **4. Distributions from Mutual Funds and Depositary Receipts**

Dividends now include distributions from mutual funds and other collective investment vehicles with the exemption of real estate funds and they are subject to the normal withholding tax rates of 5%/10%.

The definition of Dividends has been extended to include distributions from shares held in the form Depositary Receipts.

## **5. Changes relating to interest**

The definition of interest now includes income from debt-claims of every kind, whether or not secured by mortgage or carrying a right to participate in the debtor's profits but does not include penalty charges for late payment or interest which is reclassified as dividends by virtue of other provisions.

Any interest, interest which is reclassified as dividends from the Russian Tax authorities will be subject to the same withholding tax rates as dividends.

An agreement has been reached between Russian and Cypriot authorities to suspend the taxation of profits from the sale of shares of companies deriving more than 50% of their value from immovable property located in Russia.

## **6. Withholding tax rates**

The withholding tax rates in accordance with the treaty are as follows:

Dividend – 5% where the investment is more than EUR100.000, otherwise is 10%

Interest – 0%

Royalties – 0%

In case of any further clarification please do not hesitate to contact us. Our contact details:

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